NO. 51

IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

F. DONALD ARROWSMITH and RUTH R. BAUER, Executors of the Last Will and Testament of FREDERICK R. BAUER, Deceased, and RUTH BAUER, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit.

BRIEF FOR EDGAR J. KAUFMANN AS AMICUS CURIAE.

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Consent to File.

This brief *amicus curiae* is filed pursuant to Rule 27, Paragraph 9, of the Court's rules. The consent of the petitioners and of the respondent have been obtained and filed with the clerk.

Preliminary Statement.

This brief is filed for Edgar J. Kaufmann who, together with certain other taxpayers similarly situated, has now pending in the Court of Appeals for the Third Circuit a petition for review of a decision of The Tax Court of the United States in which the question involved is

similar to that presented for decision in the instant case. Edgar J. Kaufmann and the other taxpayers were formerly stockholders of Kaufmann Department Stores Securities Corporation which was merged in the year 1938 into Kaufmann Department Stores, Inc., by a statutory merger pursuant to which the stockholders of Kaufmann Department Stores Securities Corporation received stock of Kaufmann Department Stores, Inc., the surviving corporation in the merger. In the years 1943 and 1944, Edgar J. Kaufmann and his fellow stockholders paid certain liabilities of Kaufmann Department Stores Securities Corporation for federal income taxes and Pennsylvania corporate loans and corporate franchise taxes and penalties, assessed or asserted subsequent to the merger. The Tax Court held that the stockholders were entitled to deduct as losses in the years of payment a portion of the amounts so paid, but that such losses constituted capital losses, deductible only as such, rather than ordinary losses. *Edgar J. Kaufmann et al.*, 10 TCM 790. Petitions for review of the Tax Court's decision by the Court of Appeals for the Third Circuit were filed by the stockholders on April 18, 1952, and by agreement between the petitioners and the respondent, approved by the Court, further proceedings on the review have been held in abeyance pending the decision of this Court in the instant case.

While the *amicus curiae* agrees in general with the position of the petitioners in the instant case, it is felt that a further statement of the primary reason why it is considered that the payment of the judgment is deductible as an ordinary, rather than a capital, loss may be of assistance to the Court in disposing of the question presented.

Argument.

The court below has not controverted the fact that the liabilities paid by the petitioners in 1944 constituted deductible losses in that year but has held that they represented capital losses, deductible only to the limited extent provided by Section 23 (g) and Sections 117 (b) and (d) of the Internal Revenue Code. (26 U.S.C. 1946 ed., sections 23 (g), 117 (b), (d)). The sole question, therefore, is whether these admitted losses were losses "from sales or exchanges of capital assets" or "from the sale or exchange of a capital asset" within the meaning of Sections 23 (g) and 117 (a) (5). If they were not losses "from sales or exchanges of capital assets," they were deductible in full in the years sustained.

It is submitted that upon the basis of the facts of record the conclusion inevitably results that the petitioners' losses were not from sales or exchanges of capital assets within the meaning of Sections 23 (g) or 117 (a) (5) of the Internal Revenue Code. The exchanges upon the liquidation occurred and were completed in prior years and any gain or losses *from the exchanges* of capital assets occurred at that time, leaving no room for a loss from the exchanges at a subsequent date. In fact the petitioners derived gains from the distributions in liquidation which were properly to be reported, and taxable as such, in the years when the liquidating distributions were made. The assets acquired by the petitioners upon liquidation were received under a claim of right, without restriction as to their disposition. Under such circumstances, this Court has held that the income so derived must be returned for taxation in the year received, even though the taxpayer may later be adjudged liable to re-

store its equivalent. *North American Oil Consolidated v. Burnet,* 286 U. S. 417, 424.

The petitioners' deductible losses in the subsequent year were the result of a suit for an accounting, having no connection with the prior exchanges on liquidation, and the judgment procured by the plaintiff in that suit. This was a transaction separate from the liquidation exchanges and should be treated separately. If the suit had never been entered or if the plaintiff had been unsuccessful in the suit no loss would have resulted.

The court below held that the losses were capital losses on the ground that the losses in the taxable year "show up as arising out of a 'sale or exchange.'" If by this it meant to hold that the loss was from a sale or exchange within the meaning of the applicable sections of the Internal Revenue Code, its conclusion has no support in the facts of record and actually is contrary thereto. The petitioners' losses were related to their prior exchanges only indirectly in the sense that, if the petitioners had not received corporate assets on the exchanges, they would not have incurred the liability (disregarding for the moment the fact that the petitioner Bauer was liable both personally and as transferee). In a limited sense they arose as a result of the acquisition of the property upon the exchanges, rather than from the exchanges. But it is submitted that they were not losses from the exchanges within the meaning of the applicable sections of the Code, since the exchanges resulted in gains, taxable as such, and not in losses, and the losses in the subsequent year arose primarily from the successful prosecution of his claim by a creditor.

Where gains were involved in a subsequent year with respect to assets acquired on a prior liquidation exchange, the Commissioner of Internal Revenue has successfully urged that the principle of the identity and independence of each taxable year required that such gains be treated as ordinary income rather than from a sale or exchange. *Osenbach v. Commissioner of Internal Revenue*, 198 F. 2d 235 (C.A. 4th). A similar result should follow here with respect to losses. For the above reasons, without more, it is submitted that the court below erroneously held that the petitioners' losses were losses from the sale or exchange of capital assets deductible only to the limited extent provided by Section 117 of the Internal Revenue Code. Its decision on the basis of the stipulated facts is contrary to the law.

Respectfully submitted,

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